92-1846

No.

In The

Supreme Court of the United States

October Term, 1992

MARC ALAN LEVIN, EXECUTOR, ESTATE OF MYRTLE S. LEVIN PRINCE, DECEASED,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Internal Revenue Service may convert the estate tax rate mechanism (section 2001(b) of the Internal Revenue Code) into a device for collecting a time-barred gift tax, thus effectively repealing the gift tax statute of limitations (section 6501(a) of the Internal Revenue Code).

PARTIES TO THE PROCEEDING

Petitioner herein, petitioner in the United States Tax Court and appellant in the United States Court of Appeals for the Fourth Circuit, is the Estate of Myrtle S. Levin Prince, with Marc Alan Levin serving as its personal representative (executor). Respondent is the Commissioner of Internal Revenue.

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No.

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PETITION FOR A WRIT OF CERTIORARI

The Estate of Myrtle S. Levin Prince, by and through its executor, Marc Alan Levin, hereby petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the Fourth Circuit is reported at 986 F.2d 91

(4th Cir. 1993), and is reprinted in Appendix A hereto at 1a-7a.[1] The opinion of the United States Tax Court is reported at 61 T.C.M. (CCH) 2594 (1991), and is reprinted in Appendix B hereto at 8a-15a.

STATEMENT OF JURISDICTION

The judgment of the Fourth Circuit was entered on February 19, 1993. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 2001(b)[2] of the Internal Revenue Code provides:

> (b) Computation of tax. — The tax imposed by this section shall be the amount equal to the excess (if any) of —
>
> (1) a tentative tax computed under subsection (c) on the sum of —
>
> (A) the amount of the taxable estate, and
>
> (B) the amount of the adjusted taxable gifts, over
>
> (2) the aggregate amount of tax which would have been payable under chapter 12

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1. References to the Appendix to this Petition are cited herein as "App. at __a."

2. All section references unless otherwise indicated are to the Internal Revenue Code of 1954 (Title 26 of the United States Code), as amended and in effect on the date of the decedent's death.

> with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.
>
> For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

26 U.S.C. § 2001(b).

Section 2503(a) of the Internal Revenue Code provides:

> (a) General definition. — The term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (section 2522 and following).

26 U.S.C. § 2503(a).

Section 2504(c) of the Internal Revenue Code provides in relevant part:

> (c) Valuation of certain gifts for preceding calendar periods. — If the time has expired within which a tax may be assessed under this chapter . . . on the transfer of property by gift made during a preceding calendar period, as defined in section 2502(b), and if a tax under this chapter . . . has been assessed or paid for such preceding calendar period, the value of such gift made in such preceding calendar

> period shall, for purposes of computing the tax under this chapter for any calendar year, be the value of such gift which was used in computing the tax for the last preceding calendar period for which a tax under this chapter . . . was assessed or paid.

26 U.S.C. § 2504(c).

Section 6501(a) of the Internal Revenue Code states in relevant part:

> (a) General Rule. — Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

26 U.S.C. § 6501(a).

STATEMENT OF THE CASE

This case presents a question having extremely important implications for the federal gift and estate tax systems, as well as an issue of fairness in the administration of the tax law.

The statute of limitations — including the gift tax statute of limitations — performs a vital task in the tax law, providing finality and repose after a limited period and protecting both the government and taxpayers against stale claims, lost evidence, faulty memories and missing or deceased witnesses. The Internal Revenue Service believes that, in section 2001(b), it has found the

proverbial philosopher's stone with which it can dissolve the gift tax statute of limitations. In all cases, the IRS need only wait until the donor dies and then subject any time-barred gift to the estate tax in accordance with its misreading of section 2001(b).

Should the Commissioner's position in this case be allowed to stand, a real concern exists that the "judicial licensing" of these IRS practices will strongly tempt the Revenue Service to expand these unfair tactics into other areas of the tax law.

The two courts which have addressed this issue in a different, but related, context have sharply disagreed as to the proper outcome.[3] In fact, the Tax Court was itself internally divided, with eight judges dissenting in *Smith*.[4]

The issue here is simple: Did Congress, in enacting section 2001(b), implicitly repeal the gift tax statute of limitations and in the process create a whole new class of property subject to the estate tax, namely any completed *inter vivos* gift that the Commissioner decides to challenge after the donor's death? This is the real question presented by this case, and Petitioner believes that the answer is obvious — Congress did no such thing.

A. Statement of Facts

During 1984, the decedent, Myrtle S. Levin Prince, transferred Atlanta, Georgia Project Notes having a stipulated value of $20,000 to her three children. On her 1984 Federal Gift

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3. *See Boatmen's First National Bank of Kansas City v. United States*, 705 F. Supp. 1407 (W.D. Mo. 1988) and *Estate of Smith v. Commissioner*, 94 T.C. 872 (1990).

4. In fact, the Fourth Circuit's opinion below specifically decided the exact issue raised in *Smith* by holding that section 2504(c) applies only to the gift tax and not the estate tax. By so holding, the Fourth Circuit put itself in direct opposition to the holding in *Boatmen's*.

Tax Return (Form 709), the decedent reported various gifts made during the calendar year.[5] However, under the authority of the United States Court of Appeals for the Seventh Circuit in *Haffner v. United States*, 757 F.2d 920 (7th Cir. 1985), *aff'g*, 585 F. Supp. 354 (N.D. Ill. 1984), the decedent did not include the transfer of the Project Notes in Total Gifts of the Donor on Line 1, Schedule A of the return. The transfer was, however, fully disclosed on the face of the return as required by applicable law.[6]

Myrtle S. Levin Prince died on March 4, 1985, and her Federal Estate Tax Return (Form 706) was timely filed on June 4, 1986. On April 13, 1987, an IRS attorney charged with examining the estate tax return wrote the Petitioner-Estate that the position of the IRS

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5. Myrtle S. Levin Prince also made gifts in years other than 1984. During her lifetime, the decedent made taxable gifts totalling $128,134, excluding the disputed $20,000 of Project Notes. Her unified credit of $121,800 under then applicable law was not exhausted prior to her death.

6. Tax Reform Act of 1984, Pub. L. No. 369, 98th Cong. 2d Sess., 98 Stat. 939 (1984). The Act made Project Notes prospectively subject to the gift and estate taxes, but specifically left the issue of transfers prior to enactment to the courts. *See* section 641(b)(3). In keeping with this philosophy of non-intervention regarding pre-enactment transfers and in order to prevent the IRS from being disadvantaged (*see* the General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170, 98th Cong., Pub. L. 98-369) Prepared by the Staff of the Joint Committee on Taxation, at 971), section 642(a) of the Act required that any taxpayers who transferred public housing bonds (Project Notes) during the period January 1 to June 19, 1984 report information to the IRS in a form which would be sufficient to allow the IRS to identify such transfers and assess the appropriate tax in the event that the transfers were ultimately determined by the courts to be taxable. This is particularly important because it shows that not only did the Petitioner-Estate follow the letter of the law exactly, but in addition the entire statutory solution was predicated on giving the IRS precisely the opportunity to deal with this problem, which opportunity it squandered and is now trying to make up for by perverting the meaning of yet another statutory scheme — the estate tax rate mechanism.

was that Project Notes, such as the ones transferred by the decedent, are not exempt from federal estate and gift taxation.[7] Nonetheless, the IRS allowed the 1984 gift tax statute of limitations to simply expire on April 15, 1988 without taking any further action.[8] Specifically, no assessment of gift tax was made by the IRS prior to April 15, 1988 on account of the taxability of the Project Notes, nor was an adjustment of any nature to the decedent's 1984 gift tax return ever proposed by the IRS. No notice of deficiency was ever issued concerning the 1984 gift tax return.

On June 2, 1989, the IRS issued a Notice of Deficiency with respect to decedent's estate tax return which in part determined that the Project Notes were includible in "adjusted taxable gifts" in determining the estate tax. The net effect of this inclusion was to cause the estate to incur an estate tax on the full value of the Project Notes. The estate was also denied any subtraction under section 2001(b)(2) for the amount of gift tax which would have been payable on the transfer of the Project Notes. It is really this double penalty — inclusion in "adjusted taxable gifts" but no complementary reduction for gift taxes payable — which creates the opportunity for the IRS to exploit the estate tax rate mechanism as a means of collecting a time-barred gift tax.

B. Proceedings Below

The case was submitted fully stipulated to the United States Tax Court, which had obtained jurisdiction pursuant to section 7442 of the Internal Revenue Code of 1986. On May 14, 1991, the Tax Court issued a memorandum opinion sustaining the position of

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7. *Citing* Action on Decision 1986-033 and Rev. Rul. 81-63.

8. Prior to the expiration of the limitations period, this Court decided *United States v. Wells Fargo Bank*, 485 U.S. 351 (1988), effectively overruling the Seventh Circuit's holding in *Haffner* and ruling that the Project Notes were not exempt from gift and estate taxation.

the Commissioner. A final decision was entered by the Tax Court on December 5, 1991.

In the Tax Court, the government's sole contention was that this case was controlled by section 2504(c)[9] and the Tax Court's decision in *Estate of Smith v. Commissioner*, 94 T.C. 872 (1990). At the outset, the Tax Court rejected respondent's contention that section 2504(c) applied to this case. The basis for this holding was that no gift tax had been "assessed or paid" during 1984, as required for section 2504(c) to become operative, and that the use of a taxpayer's unified credit does not constitute the payment of a gift tax.

The Tax Court next turned its focus to section 2001(b) and its reference to "taxable gifts (within the meaning of section 2503)". Construing the language of the mentioned sections in a hyper literal manner, the court held that under section 2503 the gifts in question would be "taxable gifts" and therefore "adjusted taxable gifts" under section 2001(b). The court reached this conclusion by mechanistically referring to section 2503(a) wherein "taxable gifts" are defined as the total gifts made during the calendar year less the deductions provided for by sections 2522 and following. The court determined that sections 2522 and following do not provide a deduction for gifts on the basis that the gift tax statute of limitations has run, and therefore literally the Project Notes constituted "taxable gifts". The Tax Court rejected the Estate's urging that the limitations provisions (section 6501) transcend the literal wording of a specific code section, and that common sense dictates that a gift loses its character as "taxable" after the applicable limitations period has expired.

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9. Section 2504(c) provides that where the gift tax statute of limitations has expired with respect to a gift and a gift tax was paid or assessed, the value of that gift as previously reported on the gift tax return is considered conclusively established when calculating the gift tax for any subsequent taxable periods.

Finally, the Tax Court rejected the Estate's policy arguments without any discussion of their merits and completed the inequity by holding that the Estate was not entitled to a deduction under section 2001(b)(2) for gift tax which "would have been payable under chapter 12 with respect to the gifts" on the basis that the gifts would have been subject to the unified credit which, as the court held earlier, would not have qualified as the payment of a gift tax.

On March 3, 1992, the Estate noted its appeal to the United States Court of Appeals for the Fourth Circuit. The case was argued on October 30, 1992. A decision was reached on February 19, 1993, affirming the judgment of the Tax Court.

The Fourth Circuit's decision, although agreeing in result with the Tax Court, was arrived at in a significantly different and somewhat unclear fashion. The court first held that section 6501(a), although barring assessment of a gift tax on the Project Note transfer, "nowhere prohibits consideration of that transfer as an 'adjusted taxable gift' when computing the estate tax". While no explanation was provided to support this conclusion, the court did note in the very next sentence that "[i]n effect, the taxpayer seeks to promote the incorrect nontreatment of the $20,000 as subject to gift taxes as a basis for gaining a double deduction." Presumably the court felt that the Estate somehow acted improperly in failing to pay gift tax on the Project Note transfer and was now trying to parlay this into a double windfall. The Fourth Circuit clearly failed to understand the factual background of the case, for as stated earlier, the Project Note transfer was duly reported on the face of the return in full compliance with the Tax Reform Act of 1984. The Estate followed the letter of the law — it was the Commissioner who dropped the ball by not taking the appropriate responsive action even after the problem was brought directly into focus. Furthermore, it is unclear that the Fourth Circuit even understood the question presented because the Estate did not take even one, much less two, deductions for the Project Notes.

The Fourth Circuit next focused on a provision of prior law (section 2035(a)) under which gifts made within 3 years of death (in "contemplation of death" prior to 1976) were pulled back into the gross estate when computing the estate tax. Admittedly, the transfer of the Project Notes here was made within three years of the decedent's death, and perhaps Judge Murnaghan believed that Congress was remiss in repealing section 2035(a) as a basis for taxation, but section 2035(a) was repealed in 1981 and this gift took place in 1984. The Fourth Circuit's reliance on this former provision is misplaced and once again adds suspicion as to whether the court truly understood the issue it was deciding.

Finally, the Fourth Circuit reached section 2504(c). Unlike the Tax Court which had held section 2504(c) inapplicable by its own terms, the Fourth Circuit dealt directly with the *Estate of Smith* issue and held section 2504(c) to be applicable solely to gift tax issues. The court specifically refused to extend its protection to the estate tax, ruling in effect that section 2504(c) is not incorporated into section 2001(b) by virtue of the reference to section 2503. This holding puts the *Boatmen's-Smith* line of cases directly into play here.

REASONS FOR GRANTING THE WRIT

It has been written that allowing the IRS to "undo" the negative effects of missing the gift tax statute of limitations amounts to a judicially created "loophole" in favor of the government.[10] Indeed, the IRS has been quick to exploit this unfair advantage by instructing its personnel to disregard the running of the gift tax statute of limitations:

> Remember that even though a gift has been reported on a 709 and the usual statute of

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10. Spalding, *The IRS May Go Gift Shopping — For Estate Tax Dollars*, 17(2) MICH. TAX LAWYER 10, 15 (1991).

> limitations has run, for purposes of determining adjusted taxable gifts for estate tax purposes, the examiner is not foreclosed from changing the values of the gifts as reported.

Vol. II Internal Revenue Manual Part IV (Audit) § (20) 20.

I.

CERTIORARI SHOULD BE GRANTED BECAUSE THE DECISION BELOW EFFECTIVELY REPEALS THE GIFT TAX STATUTE OF LIMITATIONS.

Congress enacted the statute of limitations provisions to bring finality to tax issues after the passage of a certain time period (generally three years). The effect of the position taken by the IRS and sanctioned by the courts below would be to extend this three year period until the death of the donor, no matter how delayed, whereupon through the simple expedient of increasing "adjusted taxable gifts" on the estate tax return, the long stale gift issues could be resurrected by the Commissioner. This is certainly not what Congress intended.

Many real dangers are posed if the decision below is allowed to stand. For example, a deceased taxpayer's representative may be required to prove the nonexistence of an alleged gift the IRS may assert to have been made five, ten, twenty or even fifty years earlier. Even if the fiduciary were lucky enough to be administering for a decedent who retained scrupulous records of his or her gift activities for all the years he or she was alive, the difficulty in proving a negative (*i.e.*, that no taxable gift had been made or what the actual value of that gift might have been) in order to rebut the presumption of correctness of the IRS's determination[11] would in most cases be nearly impossible.

11. *See Helvering v. Taylor*, 293 U.S. 507, 514-516 (1935).

II.

CERTIORARI SHOULD BE GRANTED BECAUSE THE DECISION BELOW INCORRECTLY CREATES A NEW CLASS OF PROPERTY SUBJECT TO THE ESTATE TAX — COMPLETED *INTER VIVOS* GIFTS.

The estate tax statutory scheme created by Congress is actually very elegantly and thoughtfully designed.[12] Included in the gross estate (by virtue of section 2031) are all of those assets which a person possessed at the time of death. Also included are incomplete gifts, *i.e.*, certain assets "given away" during the person's lifetime, but given in such a way that Congress has deemed that complete ownership has not been passed to the donee.[13] In such situations, Congress concluded that assets given away with reservations of entitlement or power are assets that a person never really disposed of *inter vivos* and accordingly Congress deemed the person to have died "constructively" possessing the property. Congress has thought about this retained interest problem a great deal, and has created certain well-defined circumstances in which a donated asset will be considered ineffectively gifted and thereby includible in the gross estate. Thus, for example, Congress clearly provided that a decedent is

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12. Part III of Chapter 11A of the Internal Revenue Code (26 U.S.C. §§ 2031 through 2046) exclusively sets forth what assets are to be included in the gross estate. It is generally accepted that unless an asset is described in one of these sections, it is not properly includible in the gross estate.

13. Transfers of this class are commonly referred to as "incomplete gifts", as distinguished from "complete gifts" where the transferor has parted with all dominion and control over the property. Of course, an "incomplete" gift could become "complete" prior to a transferor's death simply by the relinquishment of his control over, or continued interest in, the asset. This is why it is generally accepted that when a gift is "complete", the appropriate moment is at hand to levy a gift tax.

subject to estate tax on property purportedly given away during lifetime but as to which the donor retains significant elements of control.[14]

To this list of incomplete gifts subject to the estate tax, the Fourth Circuit has unilaterally added another class of assets: property gifted *inter vivos* with complete divestiture of dominion and control by the donor. Prior to the Tax Court's opinion in *Estate of Smith* which was embraced by the Fourth Circuit, it was beyond peradventure that such a transfer constituted a completed taxable gift subject to gift tax, but was outside of the gross estate and absolutely not subject to estate tax. This miscue by the Fourth Circuit in adopting such reasoning clearly has grave implications as it upsets the estate and gift tax system in its entirety.

The way the Fourth Circuit reaches its remarkable result is obvious on the face of its opinion. Prior to 1981, there was a single class of property includible in the gross estate even though completely disposed of during a person's lifetime. This was property given away within three years of death (or, prior to 1976, given away at anytime, but given in "contemplation of death") 26 U.S.C. § 2035(a). The Fourth Circuit mentions this provision, and points out that under this prior law "the $20,000 would have been included in the gross estate for computing the federal estate tax." The court then holds that "[t]he unification of the estate and gift taxes was not created to allow taxpayers to circumvent the federal estate tax." Clearly, the Fourth Circuit is applying a repealed

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14. Where the transferor retains possession or enjoyment of the gifted property, or the right to its income, the property is includible in the gross estate. 26 U.S.C. § 2036(a)(1). It does not matter for these purposes how long before death the gift was made. Likewise, transfers taking effect only upon the donor's death are includible in the donor's estate, under the philosophy that the donor-decedent never really divested himself of the property prior to his death. 26 U.S.C. § 2037(a). *See also*, 26 U.S.C. § 2038 (revocable transfers) and 26 U.S.C. §§ 2041, 2043.

statute (section 2035(a)) by rationalizing that the concept embodied in section 2035(a) somehow continues to exist even in the absence of specific statutory language following the unification of the estate and gift tax system[15]; even though the unification took place in 1976, long before the 1981 repeal of section 2035(a)[16].

The simple fact is that since the repeal of section 2035(a) in 1981, the statute does not subject completed *inter vivos* transfers to estate tax. The Project Notes here were transferred in 1984 without any interest or right being retained by the donor. To now allow a transfer of this type to be subjected to estate tax undermines all that Congress has sought to achieve in this area.

It is absolutely clear from the legislative history of section 2001(b) that Congress never contemplated that, by setting up a

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15. Although one practical effect of the unification of the estate and gift tax rate schedules in 1976 was to reduce the significance of whether a particular transfer was subject to gift tax (previously a much lower rate) or estate tax, the 1981 repeal of section 2035(a) did have two very significant and lasting effects — (1) permanently exempting from tax (both gift and estate) any further appreciation between the date of gift and the date of death, and (2) denying property gifted within three years of death a step-up in basis under the rules of section 1014. *See* the General Explanation of the Economic Recovery Tax Act of 1981 (H.R. 4242, 97th Cong., Pub. L. 97-34) Prepared by the Staff of the Joint Committee on Taxation 262 (1981).

16. In fact, section 2035(a) was amended in 1976 to replace the unworkable "contemplation of death" standard with an objectively determinable within-three-years-of-death rule. Modifying and reenacting section 2035 in 1976 is obviously inconsistent with the notion that section 2035 was not formally needed after unification due to the effect of combining the estate and gift tax systems. Also of continuing significance is the fact that after the 1981 repeal of section 2035(a), appreciation between the date of the gift and the date of death has not been includible in the gross estate and a basis step-up could no longer be obtained. Thus the repeal of section 2035(a) was much more than simply the repeal of a "deadwood" provision.

method for maintaining a continuous rate structure, it was inadvertently allowing completed lifetime gifts to become subject to estate tax.[17] Congress has spoken unambiguously as to the types of transfers that are subject to the estate tax, and gifts such as the one here in question are clearly not in that realm.

III.

CERTIORARI SHOULD BE GRANTED BECAUSE OF A SPLIT OF AUTHORITY AS TO THE PROPER INTERPRETATION TO BE GIVEN TO THE MEANING OF SECTION 2001(b).

In *Boatmen's First National Bank of Kansas City v. United States,* 705 F. Supp. 1407 (W.D. Mo. 1988), the court confronted for the first time the question of whether the reference in section 2001(b) to "taxable gifts (within the meaning of section 2503)" is exclusive, or whether a proper interpretation of the phrase "taxable gifts" would necessitate looking beyond section 2503 to any other gift tax related provisions which bear upon the issue. The court in *Boatmen's* logically held that all of the gift tax provisions (and particularly section 2504(c)) were incorporated into section 2001(b) by reference. A short time later, a sharply divided Tax Court reached the opposite conclusion in *Estate of Smith v.*

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17. The legislative purpose of section 2001(b) was solely to provide a computational mechanism for insuring the proper marginal rate of taxation, and subjecting to tax property not otherwise deemed to be part of the gross estate was absolutely not an intended result. *See* the General Explanation of the Tax Reform Act of 1976 (H.R. 10612, 94th Cong., Pub. L. 94-455) Prepared by the Staff of the Joint Committee on Taxation 527-530 (1976); *see also,* Stephens, Maxfield & Lind, *Federal Estate and Gift Taxation,* ¶ 1.02[4] at 1-14 ("... to permit post-1976 lifetime gifts not otherwise of estate tax significance to push the taxable estate into the higher brackets...") and ¶ 2.01 at 2-2 ("The computation under that section [2001(b)] is not supposed to tax any gratuitous transfers twice; the taxable estate is still the only amount that is being taxed." (6th Ed. 1991).

Commissioner, 94 T.C. 872 (1990). The case at bar squarely presents the question once again.

It is absolutely clear that when Congress enacted section 2001(b) it never contemplated, intended or even conceived that the Commissioner would attempt to use section 2001(b) to levy an estate tax on an *inter vivos* completed transfer for which the gift tax is barred by the statute of limitations. The legislative history clearly demonstrates that section 2001(b) was enacted solely as a rate mechanism device designed to insure that the marginal tax rate on a person's estate assets begins at the highest marginal rate achieved by virtue of the decedent's lifetime giving program. *See* H.R. REP. No. 1380, 94th Cong. 2nd Sess. 12-15 (1976). Nothing in the legislative history even hints that Congress anticipated section 2001(b) would be used as a substantive provision to bring items other than those described in Part III of Chapter 11A of the Internal Revenue Code into the gross estate to be subject to tax.[18]

What is clear from all this is that a fundamental and critically important question remains to be answered by this Court; namely, does it offend the fundamental notions of justice and fair play to allow the Commissioner to trample on the gift tax limitations statute in the guise of collecting an estate tax on property long since completely given away.

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18. *See* footnote 12, *supra*, and the accompanying text.

CONCLUSION

The decision of the Fourth Circuit subjects a lifetime completed gift to the estate tax upon the donor's death, effectively eliminates the gift tax statute of limitations as a bar to delayed assessment of gift tax by the government, judicially resurrects the gift-within-three-years-of-death rule repealed by Congress in 1981, and distorts the estate tax system. The decision herein has a significant potential impact on every lifetime gift. If the IRS is sustained and this decision is permitted to stand, no lifetime gift would ever again have predictably final results. Accordingly, this case presents a nationally-significant question of federal law that merits this Court's attention.

For all of the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 18, 1993

APPENDIX A —OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED FEBRUARY 19, 1993

No. 92-1306

MARC ALAN LEVIN, Executor, Estate of Myrtle S. Levin Prince, Deceased,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

On Appeal from the United States Tax Court.
(Tax Ct. No. 89-21309)

Argued: October 30, 1992

Decided: February 19, 1993

Before MURNAGHAN and HAMILTON, Circuit Judges, and KAUFMAN, Senior United States District Judge for the District of Maryland, sitting by designation.

Affirmed by published opinion. Judge Murnaghan wrote the opinion, in which Judge Hamilton and Senior Judge Kaufman joined.

COUNSEL

ARGUED: Marc Alan Levin, McLean, Virginia, for Appellant. Kenneth W. Rosenberg, Tax Division, UNITED STATES

Appendix A

DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee. ON BRIEF: James A. Bruton, Acting Assistant Attorney General, Gary R. Allen, Kenneth L. Greene, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee.

OPINION

MURNAGHAN, Circuit Judge:

Here we are called upon to consider the interplay of federal gift tax and the federal estate tax.

Myrtle Levin Prince, while herself living, made in 1984 gifts of Atlanta Project Notes worth $20,000, as well as gifts of other property which made the annual gift tax exclusion for each donee[1] unavailable with respect to the $20,000 gift. Nor was the spousal sharing of the gift[2] applicable.

At the time the 1984 gift tax return was filed, what authority there was, *Haffner v. United States,* 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd,* 757 F.2d 920 (7th Cir. 1985), held that a gift of Atlanta Project Notes was not subject to taxation, Prince, relying on the Seventh Circuit Court's decision, referred, in the 1984 gift tax return, to the $20,000 in gifts[3] but did not rely on a reduction of her

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1. 26 U.S.C. § 2503(b).

2. 26 U.S.C. § 2513(a).

3. On her return, Mrs. Prince reported various gifts and added the following: "On May 30, 1984, the donor made gifts (exempt from gift tax under the Housing Act of 1937) of Atlanta, Georgia Project Notes, 5.82%, issue date 4-1-84, due 3-5-85. . . ."

unified gift tax credit.[4] She rather treated the $20,000 as not subject to the gift tax. As a result of reliance on Mrs. Prince's annual gift tax exemption and partial use of her unified credit, Mrs. Prince's gift tax return reported no gift tax due for 1984.[5]

Mrs. Prince then died on March 4, 1985. The United States Supreme Court issued on March 23, 1988, an opinion undermining the Seventh Circuit's holding in *Haffner. See United States v. Wells Fargo Bank*, 485 U.S. 351 (1988).

The government, despite that alteration of applicable authority, took no step asserting the taxable status of the $20,000 in gifts before the statute of limitations for gift tax ran on April 15, 1988.[6] The reason advanced to excuse the inaction was that its assertion of gift tax would have been frustrated by the Prince estate's application of its unused unified credit.

However, before limitations to impose estate tax had run, the Internal Revenue Service, on June 2, 1989, asserted liability for estate tax for the claim which we now must consider, namely, that the $20,000 should be included as "adjusted taxable gifts" for computing the federal estate tax under 26 U.S.C. § 2001(b).[7]

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4. 26 U.S.C. § 2505.

5. It also has been undisputed throughout that even if the Project Notes had been included in the total taxable gifts on the return, no gift tax would have been due. Any gift tax liability on the Project Notes would have been offset by the use of Mrs. Prince's remaining available unified gift tax credit.

6. *See* 26 U.S.C. § 6501(a) (providing generally for a 3-year limitation period for assessment of a tax).

7. Section 2001(b) provides:

(Cont'd)

Appendix A

Although the statute of limitations set forth in § 6501(a) bars the assessment of a gift tax on the transfer of the $20,000, the statute, contrary to the estate's assertion, nowhere prohibits consideration of that transfer as an "adjusted taxable gift" when computing the estate tax. In effect, the taxpayer seeks to promote the incorrect non-treatment of the $20,000 as subject to gift taxes as a basis for gaining a double deduction. The uniform deduction is not employed, on her approach, for gift tax purposes, though it could have been. In consequence, the remaining uniform deduction would be $20,000 greater than it should be for estate tax purposes.

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> (b) Computation of Tax.—The tax imposed by this section shall be the amount equal to the excess (if any) of—
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> (1) a tentative tax computed under subsection (c) on the sum of—
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> (A) the amount of the taxable estate, and
>
> (B) the amount of the adjusted taxable gifts, over
>
> (2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includible in the gross estate of the decedent.

Appendix A

The estate tax in force prior to the 1976 unification of estate and gift taxes called for taxation of transfers in "contemplation of death,"[8] refined in 1976 to transfers made within three years of death.[9] Under the prior scheme, then, the $20,000 would have been included in the gross estate for computing the federal estate tax.[10] The unification of the estate and gift taxes was not created to allow taxpayers to circumvent the federal estate tax. One could hardly hope to escape estate tax today, when the *estate tax* statute of limitations has not expired, by not paying the gift tax when due and by then relying on the running of the *gift tax* statute of limitations as a bar to the assessment of estate tax.

Finally, the provision of 26 U.S.C.§ 2504(c) on which the Prince estate alternatively seeks to rely as a reason why inclusion of the $20,000 for *estate* tax calculation purposes should be

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8. 26 U.S.C. § 2035(a), (b) (1970) (current version at 26 U.S.C. § 2035(a)).

9. 26 U.S.C.§ 2035(a) provides:

> Except as provided in subsection (b), the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decendent's death.

10. Section 2035 was amended significantly, first in 1976 and again in 1981. In 1981 Congress effectively repealed the provision by adding subsection (d):

> Except as otherwise provided in this subsection, subsection (a) shall not apply to the estate of a decedent dying after December 31, 1981.

disallowed relates only to questions of valuation for *gift* tax purposes and so is not relevant as an answer to the question with which we must deal. Section 2504(c) prohibits the IRS from challenging the valuation of gifts for gift tax purposes if the gift tax statute of limitations has expired and a gift tax has been "assessed or paid."[11] By its terms, the section addresses the gift tax, and we decline to extend it to the estate tax.[12]

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11. Section 2504(c) reads in full:

> Valuation of certain gifts for proceeding calendar periods — If the time has expired within which a tax may be assessed under this chapter or under corresponding provisions of prior laws on the transfer of property by gift made during a preceeding calendar period, as defined in section 2502(b), and if a tax under this chapter or under corresponding provisions of prior laws has been assessed or paid for such preceding calendar period, the value of such gift made in such preceeding calendar period shall, for purposes of computing the tax under this chapter for any calendar year, be the value of such gift which was used in computing the tax for the last preceding calendar period for which a tax under this chapter or under corresponding provisions of prior laws was assessed or paid.

12. Because we find that § 2504(c) applies only to gift tax calculations, we do not address the government's contentions that, irrespective of whether § 2504(c) can be imported from the gift tax into the estate tax provisions, § 2504(c) also is inapplicable in the instant case because (1) no gift tax was "assessed or paid" and (2) no prohibited "revaluation" is being attempted, as the "value" of the Project Notes at $20,000 has been undisputed throughout.

In addition, in light of the fact that § 2504(c), much like § 6501(a), functions as

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Accordingly, the Tax Court's decision is

AFFIRMED.

(Cont'd)
a kind of statute of limitations provision for gift tax, we bear in mind the general principle that " '[s]tatutes of limitation sought to be applied to bar rights of the Government, must receive a strict construction in favor of the Government.' " *Badaracco v. Commissioner*, 464 U.S. 386, 391 (1984) (quoting *E.I. DuPont de Nemours & Co. v. Davis*, 264, U.S. 456, 462 (1924)).

APPENDIX B —OPINION OF THE UNITED STATES TAX COURT FILED MAY 14, 1991

T.C. Memo. 1991-208

UNITED STATES TAX COURT

ESTATE OF MYRTLE S. LEVIN PRINCE, Deceased, MARC ALAN LEVIN, Executor, Petititioner *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 21309-89. Filed May 14, 1991.

Larry J. White and *Marc Alan Levin*, for the petitioner.

Willard N. Timm, Jr., for the respondent.

MEMORANDUM OPINION

TANNENWALD, *Judge:* Respondent determined an estate tax deficiency of $482,700.40, based in part on the omission of certain gifts for estate tax purposes, and an addition to tax of $131,686.00 under section 6660.[1] After concessions, the sole remaining issue for decision is whether respondent may include such omitted gifts made in a year which is closed to the assessment of any gift tax under section 6501 when calculating "adjusted taxable gifts" for estate tax purposes under section 2001(b)(1)(B).

This case was submitted fully stipulated, and the stipulation of facts and attached exhibits are incorporated herein by reference.

Myrtle S. Levin Prince, the decedent, died on March 4, 1985,

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1. Unless otherwise specified, all statutory references are to the Internal Revenue Code as amended, and any reference to a Rule is to the Tax Court Rules of Practice and Procedure.

and had been a resident of Georgia. At the time the petition was filed, the executor, decedent's son, Marc Alan Levin, resided in McLean, Virginia. A timely Federal estate tax return, Form 706, was filed.

Decedent began a gift-giving program in 1979. Decedent filed Federal gift tax returns, Forms 709, in each year from 1979 through 1985. On her 1984 gift tax return, decedent reported gifts (primarily stocks and bonds) and added the following:

> On May 30, 1984, the donor made gifts (exempt from gift tax under the Housing Act of 1937) of Atlanta, Georgia Project Notes, 5.82%, issue date 4-01-84, due 3-05-85.

These notes (project notes), which had a fair market value of $20,000 on the date of the gift, were not included in the total gifts on the 1984 gift tax return.[2] After taking into account decedent's annual gift tax exemption and partial use of decedent's unified credit, it was determined that there was no gift tax due for 1984. Even if the project notes had been included in the total taxable gifts on decedent's 1984 gift tax return, there would have been no gift tax due; the only adjustment would have been a further application and consequent reduction of the unified credit for future use.

The 3-year limitation period for assessment of a gift tax for 1984 expired on April 15,1988. No assessment was made nor was any notice of deficiency issued prior to that time.

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2. At the time of the filing of this return, there was authority that such notes were not subject to tax. *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd per curiam 757 F.2d 920 (7th Cir. 1985). This authority was overruled in *United States v. Wells Fargo Bank*, 485 U.S. 351 (1988).

Appendix B

During an examination of decedent's estate tax return, respondent determined that the fair market value of the project notes should be included in the "adjusted taxable gifts" for estate tax purposes, which were not so reflected in the estate tax return. The deficiency notice herein was issued on June 2, 1989.

The issue for decision is whether respondent is barred from increasing the value of "adjusted taxable gifts" for estate tax purposes under section 2001(b)(1)(B)[3] by including gifts previously omitted from a gift tax return when the time within

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3. Section 2001(b) provides:

> (b) Computation of Tax.—The tax imposed by this section shall be the amount equal to the excess (if any) of—
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> (1) a tentative tax computed under subsection (c) on the sum of—
>
> (A) the amount of the taxable estate, and
>
> (B) the amount of the adjusted taxable gifts, over
>
> (2) the aggregate amount of tax which would have been payable under chapter 12 with respect to gifts made by the decedent after December 31, 1976, if the provisions of subsection (c) (as in effect at the decedent's death) had been applicable at the time of such gifts.

For purposes of paragraph (1)(B), the term "adjusted taxable gifts" means the total amount of the taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts which are includable in the gross estate of the decedent.

which to assess a gift tax deficiency resulting from such untaxed gifts has expired under section 6501.[4]

Respondent asserts that this case is controlled by section 2504(c)[5] and our opinion in *Estate of Smith v. Commissioner*, 94 T.C. 872 (1990). Petitioner's primary contention is that, since the statute of limitations in respect of the 1984 gift tax had expired under section 6501 at the time the notice of estate tax deficiency was issued, the project notes were not "adjusted taxable gifts" within the meaning of section 2001(b)(1)(B).

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4. Section 6501(a) provides:

> (a) General Rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

5. Section 2504(c) provides in part:

> (c) Valuation of Certain Gifts for Preceding Calendar Periods.—If the time has expired within which a tax may be assessed under this chapter *** on the transfer of property by gift made during a preceding calendar period, *** and if a tax under this chapter *** has been assessed or paid for such preceding calendar period, the value of such gift made in such preceding calendar period shall, for purposes of computing the tax under this chapter for any calendar year, be the value of such gift

(Cont'd)

Under this rationale, petitioner takes the position that section 2504(c) and *Estate of Smith* do not apply herein. Alternatively, petitioner argues that the 1984 return reported the gifts at a zero value and that section 2504(c) precludes their revaluation, our decision in *Estate of Smith* to the contrary notwithstanding. For the reasons hereinafter set forth, we agree with petitioner that section 2504(c) and, except in limited respects, *Estate of Smith* do not apply to the instant case, but we disagree with petitioner's main and alternative contentions and sustain respondent's determination.

Section 2504(c) specifically provides, as a condition of its application, that a gift tax "has been assessed or paid" in respect of the barred period. *Estate of Smith v. Commissioner*, 94 T.C. at 878; H. Rept. 1337, 83d Cong., 2d Sess. 93, A322 (1954); S. Rept. 1622, 83d Cong., 2d Sess. 479 (1954). Clearly, decedent paid no tax on the gifts reported on the 1984 return, and no such tax has been assessed. Furthermore, contrary to a passing suggestion by petitioner, the use of the unified credit on the 1984 return does not constitute payment of the gift tax. *Reilly v. United States*, 88-1 USTC par. 13,752, 61 AFTR 2d 88-1332 (S.D. Ind. 1987); Rev. Rul. 84-11, 1984-1 C.B. 201. See also ABA Tax Section Recommendation No. 1980-5, Committee on Estate and Gift Taxes, 33 Tax Lawyer 1531 (1980).

We hold that section 2504(c) does not apply herein. Such being the case, *Estate of Smith v. Commissioner, supra*, is not in point, except to the limited extent hereinafter indicated.

(Cont'd)

> which was used in computing the tax for the last preceding calendar period for which a tax under this chapter *** was assessed or paid.

Appendix B

We now turn to petitioner's main contention. The latter part of section 2001(b) provides that "For purposes of paragraph (1)(B), the term 'adjusted taxable gifts' means the total amount of the *taxable gifts (within the meaning of section 2503)* made by the decedent after December 31, 1976 ***." (Emphasis added.) Section 2503(a) provides that "The term 'taxable gifts' means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (section 2522 and following)." Nowhere in section 2522 and following or elsewhere in the Internal Revenue Code is there any provision for the deduction of gifts on the basis that the statute of limitations has run. To hold that the statute of limitations provisions of section 6501 accomplish that result would produce the incongruous situation that a decedent who had filed a gift tax return reporting all gifts and paid a gift tax would be in a worse position in respect of revaluation of a gift for estate tax purposes than a decedent who failed to report an otherwise taxable gift. Cf. *Estate of Smith v. Commissioner, supra.*

Petitioner relies heavily on *Boatmen's First Nat. Bank of Kansas City v. United States,* 705 F. Supp. 1407 (W.D. Mo. 1988), and points to the fact that it was cited with seeming approval in *Fendell v. Commissioner,* 906 F.2d 362 (8th Cir. 1990), revg. and remanding 92 T.C. 708 (1989). We expressed our disagreement with *Boatmen's* in *Estate of Smith v. Commissioner,* 94 T.C. at 878, and we are not persuaded to change our view by the Eighth Circuit's citation in a case that is clearly distinguishable. Leaving aside the question whether we agree with the Eighth Circuit's disposition of *Fendell* (a question we do not decide), that case involved the issue whether the expiration of the statute of limitations in respect of the tax return of a trust precluded respondent from recalculating the distributable income of one taxpayer, i.e. a trust, in determining a deficiency in the taxable

income of another taxpayer, *i.e.*, a beneficiary of the trust whose taxable year was still open. In the instant case, the same person is both the donor and the decedent.

Petitioner makes several policy arguments in support of its position. Most of them are variations on the policy themes rejected in *Estate of Smith v. Comissioner, supra.* Petitioner has not persuaded us that we should accord favorable treatment to its policy arguments. Nor has petitioner persuaded us that we should overrule *Estate of Smith* and sustain its alternative argument.

Petitioner also suggests that, because respondent was aware of the omission of the project notes from taxable gifts on the 1984 return well before the expiration of the period of limitations for the assessment of a gift tax on April 15, 1988, he should be precluded from collecting that tax indirectly through the determination of a deficiency in estate tax. This position smacks of estoppel against the Government and clearly does not satisfy the standards for such a claim under the decided cases. E.g., *United States v. Asmar,* 827 F.2d 907 (3d Cir. 1987); *Boulez v. Commissioner,* 76 T.C. 209 (1981), affd. 810 F.2d 209 (D.C. Cir. 1987).

In sum, we hold that, under the circumstances herein, the usual rule that the basis for tax liability in a prior barred period may be recomputed for the purpose of calculating the tax liability for an open period should apply. *Hill v. Commissioner,* 95 T.C. 437 (1990) (investment credit); *Sivils v. Commissioner,* 86 T.C. 79, 83-84 (1986) (income averaging); *Lone Manor Farms, Inc. v. Commissioner,* 61 T.C. 436 (1974), affd. without published opinion 510 F.2d 970 (3d Cir. 1975) (net operating losses).

Finally, we note that, since there would have been no gift tax payable even if the decedent had included the transfers of the

project notes as taxable gifts on her 1984 return, petitioner is not entitled to any adjustment under the second prong of our decision in *Estate of Smith v. Commissioner*, 94 T.C. at 878-880.

To reflect the concessions of the parties and our decision herein,

Decision will be entered under Rule 155.